TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL MEMORANDUM

HB 1367 – SB 1363

May 9, 2017

SUMMARY OF ORIGINAL BILL: Changes the classification of property of incumbent local exchange telephone companies (ILEC) that elect market regulation pursuant to Tenn. Code Ann. § 65-5-109 and property telephone cooperatives organized pursuant to Tenn. Code Ann. § 65-29-102, from public utility to industrial and commercial property. These changes are effective January 1, 2017. Discontinues the Telecommunications Ad Valorem Tax Reduction Fund effective June 2, 2017.

FISCAL IMPACT OF ORIGINAL BILL:

Decrease State Revenue – $1,196,900/General Fund
$2,685,400/Department of Education
$15,200/Department of Revenue
$37,900/Sinking Fund

Decrease Local Revenue – Net Impact – $2,728,300

Other Fiscal Impact – The Telecommunications Ad Valorem Tax Reduction Fund will be discontinued by June 2, 2017. All revenue in the fund will be dispersed to eligible telecommunication service providers; therefore, any remaining balance will be not significant.

SUMMARY OF AMENDMENT (008767): Deletes and rewrites the original bill such that the substantive changes are as follows: defines modern market telecommunications provider (MMTP) and changes the classification of MMTPs to industrial and commercial property; redistributes the sales and use tax collected from interstate or international telecommunications services sold to businesses; implements a privilege tax for MMTPs beginning January 1, 2018, and repeals that tax on December 31, 2022; and reclassifies certain properties making payment in lieu of taxes (PILOT) beginning January 1, 2023.

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:

Increase State Revenue – Net Impact - $3,535,200/FY17-18/General Fund
$2,535,200/FY18-19/General Fund
$1,535,200/FY19-20/General Fund
$535,200/FY20-21/General Fund

Decrease State Revenue –
$4,388,100/FY17-18 and Subsequent Years/Department of Education
$18,900/FY17-18 and Subsequent Years/Department of Revenue
$47,400/FY17-18 and Subsequent Years/Sinking Fund Account
$464,800/FY21-22 and Subsequent Years/General Fund

Increase Local Revenue – Net Impact –
$36,400/Each Year FY17-18 through FY19-20

Decrease Local Revenue – Net Impact - $213,600/Each Year FY20-21 and FY 21-22
$713,600/FY22-23 and Subsequent Years

Other Fiscal Impact – The Telecommunications Ad Valorem Tax Reduction Fund will be discontinued by June 2, 2017. All revenue in the fund will be dispersed to eligible telecommunication service providers; therefore, any remaining balance will be not significant.

To the extent an eligible providers are making PILOT payments in the amount of 55 percent as of January 1, 2023, local governments may experience a decrease in property tax revenue. The amount of any future decrease in local property taxes resulting from the decrease in assessment cannot be reasonably quantified.

Assumptions for the bill as amended:

- This legislation defines a MMTP as: (1) an incumbent local exchange telephone company that elects market regulation pursuant to Tenn. Code Ann. § 65-5-109; (2) a telephone cooperative company that elects market regulation pursuant to Tenn. Code Ann. § 65-29-102; or (3) a non-governmental entity or separate operating division within the entity if the business activity of the entity or division is limited to providing competitive local exchange telephone services or interconnected voice over internet protocol services.
- Pursuant to Article 2, Section 28 of the Tennessee Constitution, public utility real property is assessed at 55 percent of its value and industrial and commercial real property is assessed at 40 percent of its value.
- Pursuant to Tenn. Code Ann. § 65-5-109(a), unused tangible personal property classified as public utility property is assessed at 55 percent of its value and unused tangible personal property classified as industrial and commercial is assessed at 30 percent of its value.

- Based on information provided by the Comptroller of the Treasury (Comptroller), decreasing real and personal property of MMTPs from a 55 percent of the assessed value to 40 percent of real property and 30 percent of personal property will result in a weighted decrease in local property tax revenue of 41.8182 percent.
- Based on information provided by the Comptroller, tax year 2016 distribution to local government for MMTPs was $35,664,267. This analysis assumes distributions to local governments are constant in future years.
- Classifying MMTPs real and personal property as industrial and commercial will result in a recurring decrease in local revenue estimated to be $14,914,155 ($35,664,267 x 41.8182%).

Assumptions Related to Sales and Use Tax:

- Pursuant to Tenn. Code Ann. § 67-6-221(a), interstate or international telecommunication services sold to businesses are subject to a sales and use tax imposed at a rate of 7.5 percent.
- Under current law, pursuant to Tenn. Code Ann. § 67-6-221(b), revenue is distributed in the following weighted percentages for the following purposes:
    - 53.33 percent Telecommunications Ad Valorem Tax Reduction Fund
    - 6.67 percent educational purposes for kindergarten through grade 12
    - 6.67 percent incorporated municipalities and unincorporated areas of counties
    - the remaining balance, or one-third of the total, deposited in the General Fund and allocated as follows pursuant to Tenn. Code Ann. § 67-6-103(a):
        - 29.0141 percent General Fund
        - 65.0970 percent Educational
        - 4.6030 percent Municipalities
        - .3674 percent Department of Revenue
        - .9185 percent Sinking Fund Account
- This legislation discontinues the Ad Valorem Tax Reduction Fund effective June 2, 2017 and reallocates interstate or international telecommunication services 7.5 percent sales and use tax as follows:
    - 6.67 percent General Fund
    - 93.33 percent distributed to municipalities and counties to reimburse for property tax reclassification reductions
- Based on information provided by the Comptroller, the annual sales and use tax revenue collected for interstate or international telecommunication services is $15,469,717. This analysis assumes this collection will remain constant in future fiscal years.
- Based on information provided by the Comptroller, the Comptroller's Office will disperse all funds in the Telecommunications Ad Valorem Tax Reduction Fund to eligible recipients. The Fund will no longer exist in FY17-18 and subsequent fiscal years.
- The redistribution of sales and use tax revenue will lead to a recurring increase in local revenue estimated to be $14,437,887 ($15,469,717 x 93.33%) for municipalities and counties.

- Under current law, total annual collections of the remaining balance are estimated to be $5,156,572 [($15,469,717 x (1/3)]. The provisions of this legislation would eliminate the balance.
- The redistribution of sales and use tax revenue will lead to a net recurring decrease to the following funds:
    - General Fund: $464,818 [($15,469,717 x 6.67%) - ($5,156,572 x 29.0141%)].
    - Educational Purposes: $4,388,088 [($15,469,717 x 6.67%) + ($5,156,572 x 65.0970%)].
    - Municipalities: $237,357 ($5,156,572 x 4.6030%).
    - Department of Revenue: $18,945 ($5,156,572 x .3674%).
    - Sinking Fund Account: $47,363 ($5,156,572 x .9185%).

Corrected assumptions related to MMTP Privilege Tax and PILOT:

- This legislation requires the state to impose a tax on MMTPs based on the pro rata share of the total assessed value of all operating property used by the MMTPs as follows:
    - FY 17-18
        - General Fund: $4,000,000
        - Local Governments $750,000
    - FY 18-19
        - General Fund: $3,000,000
        - Local Governments $750,000
    - FY 19-20
        - General Fund: $2,000,000
        - Local Governments $750,000
    - FY 20-21
        - General Fund: $1,000,000
        - Local Governments $500,000
    - FY 21-22
        - Local Governments $500,000
- Based on information provided by the Department of Revenue, privilege tax impacts will be recognized in the tax year it is imposed, for example 2018 tax year impacts will be recognized in FY17-18.
- This legislation requires the operating property of a municipal or similar provider of broadband services that provides competitive local exchange telephone services or interconnected voice over internet protocol services through a dedicated telecommunications division and making PILOT in the rate of assessment of 55 percent to be classified and assessed in the same manner as MMTPs beginning January 1, 2023.
- The amount of any future decrease in local property taxes resulting from the decrease in assessment cannot be reasonably quantified.

Corrected assumptions related to net impact of the legislation:

- The total net fiscal impact to the General Fund is estimated to be:

    - Increase in state revenue: $3,535,182 in FY17-18 ($4,000,000 privilege tax revenue - $464,818 state sales and use tax revenue).
    - Increase in state revenue: $2,535,182 in FY18-19 ($3,000,000 privilege tax revenue - $464,818 sales and use tax revenue).
    - Increase in state revenue: $1,535,182 in FY19-20 ($2,000,000 privilege tax revenue - $464,818 sales and use tax revenue).
    - Increase in state revenue: $535,182 in FY20-21 ($1,000,000 privilege tax revenue - $464,818 sales and use tax revenue).
    - Decrease in state revenue: $464,818 in FY21-22 and subsequent years ($464,818 sales and use tax revenue).
- The total net fiscal impact to local government is estimated to be:
    - Increase in local revenue: FY17-18 in $36,365 ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue + $750,000 privilege tax revenue).
    - Increase in local revenue: $36,365 in FY18-19 ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue + $750,000 privilege tax revenue).
    - Increase in local revenue: $36,365 in FY19-20 ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue + $750,000 privilege tax revenue).
    - Decrease in local revenue: $213,635 in FY20-21 ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue + $500,000 privilege tax revenue).
    - Decrease in local revenue: $213,635 in FY21-22 ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue + $500,000 privilege tax revenue).
    - Decrease in local revenue: $713,635 in FY22-23 and subsequent years ($14,437,877 sales and use tax revenue - $237,357 redistribution of sales and use tax - $14,914,155 property tax revenue)

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

Krista M. Lee

Krista M. Lee, Executive Director

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